1988 Annual Report

CUBE ENERGY CORP.

CUBE ENERGY CORP.

Cube Energy Corp. is a publicly traded Canadian controlled Corporation whose business is the exploration for, and the development and production of petroleum and natural gas reserves. All of Cube's assets are located in Western Canada.

Cube operates and maintains a controlling interest in a majority of its programs. The Corporation also manages interests in common properties for joint venture participants.

After its 1988 fiscal year end, the Corporation's shares were consolidated and its name was changed from First Devonian Explorations Ltd. to Cube Energy Corp. This name change is reflected throughout this annual report.

CORPORATE INFORMATION

HEAD OFFICE

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DIRECTORS AND OFFICERS

* Steven P. Dobrowolski
  President
Gary W. Selby
  Vice-President
* R. Gordon Cormie
  Secretary-Treasurer
Gordon M. Adams
* Frederick W. Dent
John Stein

* Member of Audit Committee

MANAGEMENT

Steven P. Dobrowolski, P. Geol.
  President
Gary W. Selby, P. Eng.
  Vice-President
Randal J. Matkaluk, C.A.
  Controller
Alan G. Franks, P. Eng.
  Production Supervisor
Gloria M. Boogmans
  Land Administrator

STOCK EXCHANGE

Alberta Stock Exchange
Symbol: CUK

REGISTRAR AND TRANSFER AGENT

Royal Trust Corporation of Canada
Calgary, Alberta

ABBREVIATIONS USED:

Bbl — Barrel
MBbl — Thousand Barrels
Mcf — Thousand Cubic Feet
MMcf — Million Cubic Feet

CUBE ENERGY CORP.

(Formerly First Devonian Explorations Ltd.)

FIVE YEAR CORPORATE PROFILE

($ in 000's Except Per Share Amounts)

	1988	1987	1986	1985	1984
FINANCIAL					
Gross Revenues	**$ 1,778**	$ 1,596	$ 1,742	$ 1,370	$ 971
Operating and Royalties	**752**	647	755	562	348
General and Administrative	**321**	266	279	184	195
Interest	**146**	227	172	108	101
Cash Flow	**559**	456	536	516	326
Earnings	**191**	89	255*	122	75
Cash Flow per Share	**.57**	.55	1.20	1.40	1.00
Earnings per Share	**.19**	.11	.50	.30	.20
Working Capital (Deficiency)	**(651)**	(273)	(231)	(1,721)	(441)
Long-Term Debt	**1,525**	2,425	2,848	1,625	1,255
Capital Expenditures	**1,411**	312	1,966	2,718	1,008
Shareholders' Equity	**3,519**	2,169	2,080	3,439	2,802
Total Assets	**6,802**	5,770	6,840	8,514	4,847
RESERVES					
Proved and Probable					
Oil — MBbl	**391**	679	890	710	752
Gas — MMcf	**11,485**	3,574	4,436	3,478	1,920
OPERATIONS					
Daily Oil Production — Bbl	**106**	135	139	75	52
Daily Gas Production — Mcf	**1,255**	335	101	171	161
DRILLING — Canada					
Oil	**4**	0	7	10	4
Gas	**5**	1	1	4	0
Dry	**2**	0	2	3	0
Service	**0**	0	0	1	0
Total	**11**	1	10	18	4
LAND HOLDINGS					
Canada — Net Acres	**14,838**	10,478	10,518	7,113	3,986
ASSET VALUE					
15% Discount Factor					
Proven	**$10,266**	$ 8,092	$ 8,436	$ 9,090	$ 8,246
Probable	**1,222**	568	1,424	2,408	1,389
Land	**129**	125	136	213	371
TOTAL	**$11,617**	$ 8,785	$ 9,996	$11,711	$10,006
Number of Employees	**6**	5	6	5	5

*Before unusual items

REPORT TO SHAREHOLDERS

Fiscal 1988 saw Cube Energy Corp. continue with its policies of consolidation and restructuring following the oil price collapse of 1986. Of more interest to shareholders, was the resumption of an exploration and development drilling program during the year with encouraging results. This was made possible through a $2,000,000 flow-through issue which was closed during the year. Since government grants are payable to the Corporation, the total financing will exceed $2,700,000, which is the largest equity issue ever completed by Cube.

Steps were taken during fiscal 1988 to restructure the Corporation's share capital which has recently culminated in the following actions taking place:

1. The Corporation voluntarily delisted from the Vancouver Stock Exchange.
2. The Common Shares of the Corporation have been consolidated on the basis of ten Common Shares of First Devonian Explorations Ltd. for each new Common Share of the consolidated Corporation.
3. In conjunction with the share consolidation, the Corporation has changed its name from First Devonian Explorations Ltd. to Cube Energy Corp.
4. In addition to maintaining its listing on the Alberta Stock Exchange, we have also undertaken to become a reporting issuer in Ontario.

We feel that these actions will in time improve our shareholders market position and allow Cube more flexibility in future financing activities.

Despite lower pricing during fiscal 1988, Cube managed to increase cash flow and earnings while reducing debt. We are particularly pleased with these results, since for the most part production from new wells drilled as a result of our flow-through program had not commenced and so did not generate any additional revenue.

Results of our flow-through eleven well drilling program include rapid growth of Cube's gas reserves through the drilling of five successful gas wells. While four out of the six wells drilled on Cube's lands for oil production were completed, we were not satisfied with our results in this area. This was principally due to the disappointing results of the two exploratory tests that were abandoned after encountering the geological target developed as projected but without any oil accumulation.

Overall, we are pleased to report that with an active drilling program Cube's net asset value at a 15 percent discount factor grew by 50 percent from $6,031,618 to $9,045,077.

Approximately one-half of our $2,000,000 flow-through program remained to be expended at year end. The remaining funds will be applied to development drilling of existing properties as well as on certain new ventures. Although Cube is now deriving over 50 percent of its revenue from gas production and will likely exceed 75 percent in gas sourced revenues within a year, we will still maintain an exposure in economically justifiable oil prospects. In contrast to past areas of activity in more northerly parts of Alberta, we now expect activity to be centered in southern Alberta.

Cube had approximately $4,500,000 of tax pools at year end which allows the Corporation to continue with other flow-through ventures. Discussions are under way to structure another flow-through issue for 1989. Together with the remaining flow-through funds from our last issue and with increasing levels of cash flow, we expect that Cube will maintain its current level of activity into 1990.

Throughout the past three years we have maintained a small technically oriented staff. Cutbacks in salaries were instituted in 1986 rather than cuts in staff. We feel that although small in number, we have retained technical expertise in all important areas of the business, so that we may continue to develop and successfully pursue economic oil and gas prospects. 1989 should be a year in which shareholders of Cube Energy Corp. again benefit from this combination of technical expertise along with adequate financial resources to implement exploration and development programs. Our thanks to shareholders who have exercised patience over the last few years while restructuring, financing and commencement of drilling programs have occurred. A special thanks to those shareholders who have assisted in financing Cube's new ventures.

Submitted on behalf of the Board of Directors.

Steven Dobrowolski
President

January 6, 1989

EXPLORATION AND PRODUCTION

Cube participated in the drilling of a total of eleven wells during fiscal 1988 resulting in four oil wells, five gas wells and two dry holes. Drilling activity was up significantly from the prior year when the Corporation only participated in the drilling of one gas well.

We continued with our philosophy of maintaining an exposure in both oil and gas prospects during the 1988 fiscal year. Overall we are pleased with the results to date. All five wells targeted for gas reserves were completed. Development drilling for gas reserves will continue in a number of areas.

Of the four tests completed as oil wells, one test which Cube operated in the Swan Hills Areas was very encouraging and has development potential. The two dry holes that Cube participated in were both targeted for large oil reserves. Tests drilled on both the Judy Creek prospect and a seismically defined feature in the Peerless Area were both particularly disappointing, since the targeted features were developed as expected, yet were barren of any oil reserves.

Our philosophy, adopted in 1985, of having interests in both oil and gas prospects will be maintained during the next year. Two overall changes will occur. A higher percentage of wells drilled will be on prospects in Southern and Central Alberta versus more northerly parts of the province. As well we expect that there will be an overall shift to a higher percentage of gas prospects in the near term.

Swan Hills - West

Cube holds a 30 percent working interest in a well drilled in the Swan Hills - West Area that was completed in June, 1988. Initial flow rates were as high as 500 barrels per day. The well is expected to produce over 80 barrels per day based on allowables in the area. An offset drilling location was drilled subsequent to year end and was cased for oil production. Cube holds working interests varying between 30 and 35 percent in 960 acres in this area.

Swan Hills - North

A well was drilled by another operator in the Swan Hills - North Area through a farmin on 160 acres of Cube's lands. The well was completed and currently produces 70 barrels of oil per day. We hold a royalty interest before payout and 7.6 percent working interest after payout in the well. A second existing offset well of Cube's was also reworked by this operator to earn a second 160 acres. The rework was marginally successful.

Harmattan

A well was drilled by Cube on a half section of land in the Harmattan Area which is situated approximately 50 miles northwest of Calgary. It produces about 25 barrels of oil per day. The Corporation holds a 30 percent working interest in the well.

McBride

A fourth multiple zone gas well was drilled in the McBride Area. Two of the four wells were producing at year end and efforts were being made by Cube, as operator of the wells, to have the remaining two wells tied in and placed on production. The bulk of Cube's gas production during fiscal 1988 was from this area. The Corporation's working interests vary from 25 to 43.9 percent in these gas wells. We now operate a 4640 acre block in McBride.

Gadsby

Four wells were drilled and cased as potential gas wells in the Gadsby Area. Cube holds a 33.3 percent working interest in these wells.

PRODUCTION

On an equivalent basis (10 Mcf = 1 barrel) production increased from 169 barrels of oil equivalent per day during fiscal 1987 to 232 barrels of oil equivalent per day for the 1988 fiscal year.

Gas production increased to 1255 Mcf per day from 335 Mcf per day achieved during the prior year. New gas wells being placed on stream will continue to increase these volumes.

Oil production fell to 106 barrels per day for fiscal 1988 from 135 barrels per day in the prior year. This decline was due to depletion of existing wells and shutting in certain marginal producers. New production from recently completed wells will increase oil production.

Our goal was to exceed a production rate of 400 barrels of oil equivalent per day upon the completion of our existing flow-through program. With the results achieved to date we are now targeting 600 barrels of oil equivalent per day as a level that is attainable once our program is complete. It is anticipated that approximately 75 percent of our production volumes will be gas.

RESERVES

Proven plus probable oil reserves fell to 391,000 barrels from 679,000 barrels due to a year of production, evaluation revisions based on performance and lower pricing expectations which shorten reserve life.

Total gas reserves increased substantially to 11,485 MMcf. These additional reserves reflect the upgrading of existing properties and new additions as a result of our drilling program.

Reserve Category	**Reserves**		**Present Value of Future Cash Flow ($M)**			
	Gas MMcf	Oil MBbl	0%	10%	15%	20%
Proven	11,275	250	21,577	12,578	10,266	8,627
Probable	210	141	2,816	1,538	1,222	993
Sub-Total	11,485	391	24,393	14,116	11,488	9,620
Undeveloped Land			129	129	129	129
Total	11,485	391	24,522	14,245	11,617	9,749

ASSET VALUE

Renewed drilling activity during fiscal 1988 reversed the decline in asset values which had commenced with the oil price collapse of 1986 and continued through 1987 due to the lack of any exploration and development drilling. Cube's total asset value utilizing a 15 percent discount factor as evaluated by independent engineering consultants was $11,617,000, up from a value of $8,785,000 determined the prior year by in house personnel.

Net asset value also increased over the prior year as debt levels were reduced by Cube. Net asset value at a 15 percent discount factor increased from $6,031,618 in 1987 to $9,045,077 at the end of fiscal 1988. Once again renewed drilling activity reversed the declining values experienced after 1986.

Net Asset Value

Asset Value (15% discount factor — 50% of probable reserves)		$11,006,000
Plus: Notes and long term receivables	$ 214,854	
	$ 214,854	$ 214,854
Sub-Total		$11,220,854
Less: Long Term Debt	$1,524,724	
Working Capital Deficiency	$ 651,053	
	$2,175,777	$ 2,175,777
Net Asset Value		$ 9,045,077

FINANCIAL

Increases in cash flow and earnings were achieved by Cube during fiscal 1988 despite the fact that no significant production occurred from new wells drilled during the year. Cash flow increased by 23 percent to $559,400 while earnings were up by 115 percent to $190,562. We look for more significant improvements in cash flow once all of our new wells are placed on stream.

Since 1985 the Corporation's debt has declined each year. While our philosophy will continue to be to reduce debt levels, we may have to utilize debt or alternately some form of lease financing to fund capital expenditures on production facilities. Our flow-through financing can only be used for intangible expenditures while tangible expenses such as gas lines, plants and production equipment must be internally funded. Over the immediate term cash flow will not be sufficient to finance the tangibles associated with our program so therefore alternate funding must be arranged.

As at year end Cube had $932,504 of flow-through financing available. Since the Corporation receives all government grants under our program this translates into approximately $1,300,000 of funding. The main advantages of our financing over the majority of other flow-through issues continues to be that expenses can be incurred in development drilling and land, as well as exploratory ventures, along with the fact that there are no time constraints on spending the funds.

CUBE ENERGY CORP.

(Formerly First Devonian Explorations Ltd.)

CONSOLIDATED BALANCE SHEET

JULY 31, 1988

	1988	1987
ASSETS		
Current assets		
Cash	**$ 28,596**	$ —
Accounts receivable	**1,079,090**	902,546
	1,107,686	902,546
Notes receivable (note 2)	**47,800**	47,800
Long-term receivables (note 3)	**167,054**	180,990
Property and equipment (note 4)	**5,479,714**	4,638,279
	$ 6,802,254	$5,769,615
LIABILITIES		
Current liabilities		
Bank overdraft	**$ —**	$ 76,988
Accounts payable and accrued liabilities	**1,758,739**	699,006
Current portion of long-term debt (note 5)	—	400,000
	1,758,739	1,175,994
Long-term debt (note 5)	**800,000**	1,700,000
Convertible demand debenture (note 6)	**724,724**	724,724
SHAREHOLDERS' EQUITY		
Share capital (note 7)	**3,239,729**	2,080,397
Retained earnings	**279,062**	88,500
	3,518,791	2,168,897
	$ 6,802,254	$5,769,615

Approved on behalf of the Board,

, Director

, Director

CUBE ENERGY CORP.

(Formerly First Devonian Explorations Ltd.)

CONSOLIDATED STATEMENT OF EARNINGS

YEAR ENDED JULY 31, 1988

	1988	1987
Revenue		
Oil and gas sales	**$1,453,333**	$1,316,967
Alberta royalty tax credit	**171,115**	172,594
Operator's fees and other	**153,779**	106,533
	1,778,227	1,596,094
Expenses		
Production	**477,996**	416,925
Royalties	**274,109**	229,626
General and administrative	**321,130**	266,154
Interest on long-term debt	**145,592**	227,479
	1,218,827	1,140,184
Working capital generated from operations	**559,400**	455,910
Charges not requiring working capital		
Depletion	**288,000**	295,000
Depreciation	**80,838**	72,410
	368,838	367,410
Earnings before income taxes	**190,562**	88,500
Income taxes (note 10(a))	—	—
Net earnings	**$ 190,562**	$ 88,500
Earnings per share (note 12)	**$ 0.19**	$ 0.11
Fully diluted earnings per share (note 12)	**$ 0.13**	$ 0.07
Cash flow per share (note 12)	**$ 0.57**	$ 0.55

CONSOLIDATED STATEMENT OF RETAINED EARNINGS

YEAR ENDED JULY 31, 1988

	1988	1987
Retained earnings (deficit), beginning of year	**$ 88,500**	$ (4,649,889)
Deficit offset against share capital (note 8)	—	4,649,889
Net earnings	**190,562**	88,500
Retained earnings, end of year	**$ 279,062**	$ 88,500

CUBE ENERGY CORP.

(Formerly First Devonian Explorations Ltd.)

CONSOLIDATED STATEMENT OF CHANGES IN FINANCIAL POSITION

YEAR ENDED JULY 31, 1988

	1988	1987
Operating activities		
Earnings before income taxes and extraordinary item	$ 190,562	$ 88,500
Items not involving cash		
Depletion and depreciation	368,838	367,410
Cash flow from operations	559,400	455,910
Net change in non-cash working capital balances	483,189	(8,993)
Cash flow from operations available for investment	1,042,589	446,917
Investing activities		
Acquisition of property and equipment	(1,767,444)	(442,896)
Petroleum and other incentive payments	356,772	130,700
Cash used in investing activities	(1,410,672)	(312,196)
Financing activities		
Repayment of long-term debt	(900,000)	(423,750)
Issuance of share capital	1,181,602	—
Share capital issuance costs	(22,270)	—
Repayment of notes receivable	—	6,250
Decrease (increase) in long-term accounts receivable	13,936	(180,990)
Disposal of property and equipment	200,399	411,973
Cash provided (used) by financing activities	473,667	(186,517)
Increase (decrease) in cash	105,584	(51,796)
Bank overdraft, beginning of year	(76,988)	(25,192)
Cash (bank overdraft), end of year	$ 28,596	$ (76,988)

CUBE ENERGY CORP.

(Formerly First Devonian Explorations Ltd.)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

JULY 31, 1988

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The consolidated financial statements of the Corporation are stated in Canadian dollars and have been prepared in accordance with accounting principles generally accepted in Canada which, in the case of the Corporation, conform in all material respects with International Accounting Standards. The significant accounting policies are summarized below:

a) Principles of consolidation

The consolidated financial statements include, in addition to the accounts of the Corporation, the accounts of its wholly-owned subsidiaries, First Devonian Exploration Inc. and Barracuda Petroleum Inc.

b) Exploration and development costs

The Corporation follows the full cost method of accounting for exploration and development expenditures, wherein all costs related to the exploration for and the development of oil and gas reserves are initially capitalized. Costs capitalized include land acquisition costs, geological and geophysical expenditures, rentals on undeveloped properties, costs of drilling productive and non-productive wells, together with overhead and interest directly related to exploration and development activities. Proceeds on minor property sales are credited to the net book value of the property and equipment. Gains or losses on major property sales are normally recognized in the statement of earnings.

Exploration and development costs are allocated to two cost centres, namely, Canada and the United States.

Costs capitalized in the cost centres are depleted on the composite unit-of-production method based on estimated proven oil and gas reserves as determined by independent and Corporation engineers.

In applying the full cost method, the Corporation performs a ceiling test which restricts the capitalized costs less accumulated depletion and depreciation for each cost centre from exceeding an amount equal to the estimated undiscounted value of future net revenues from proven oil and gas reserves, based on current prices and costs, and after deducting estimated future general and administrative expenses, financing costs and income taxes for each cost centre. In calculating the above cost centre ceiling tests, gas was converted to oil on a 7 MCF to 1 BBL equivalent basis and $17.00 Canadian per barrel of oil was used as the current price of oil.

c) Depreciation

Lease and well equipment are depreciated on the composite unit-of-production method. Other equipment is depreciated on the declining balance method at 20% per annum.

d) Joint venture accounting

Substantially all of the exploration and production activities of the Corporation are conducted jointly with others and accordingly these consolidated financial statements reflect only the Corporation's proportionate interest in such activities.

e) Earnings per share

Net earnings per share has been calculated using the weighted average number of post-consolidation (note 12) Common Shares of 984,410 outstanding during the year.

f) Cash flow per share

Cash flow per share refers to working capital generated from operations, and it has been calculated using the weighted average number of post-consolidation (note 12) Common Shares of 984,410 outstanding during the year.

g) Flow-through shares

Share capital includes flow-through shares issued pursuant to certain provisions of the Income Tax Act (Canada). The Act provides that, where the share issuance proceeds are used for exploration and development expenditures, the related income tax deductions may be renounced to subscribers. Accordingly, these expenditures provide no income tax deduction to the Corporation.

The value assigned to the properties upon which subscribers' funds were expended is the actual dollar amount of the expenditures with share capital being recorded based on cash received.

h) Accounting for changing prices

No procedures have been adopted by the Corporation to reflect the impact on the financial statements of specific price changes, changes in the general level of prices, or both.

2. NOTES RECEIVABLE

Pursuant to share purchase options exercised, the Corporation has advanced funds to certain employees to enable them to purchase Common Shares from treasury. The advances are non-interest bearing, are secured by promissory notes and are due on or before April 10, 1991.

3. LONG-TERM RECEIVABLES

Long-term receivables are due from certain officers and employees, are non-interest bearing and have no fixed terms of repayment (note 9).

4. PROPERTY AND EQUIPMENT

	Cost	Accumulated Depletion and Depreciation	Net Book Value 1988	Net Book Value 1987
Petroleum and natural gas leases and rights including exploration and development thereon	$ 8,278,245	$ 3,763,200	**$ 4,515,045**	$ 3,592,694
Lease and well equipment	1,805,565	871,000	**934,565**	1,016,383
Other equipment	93,719	63,615	**30,104**	29,202
	$10,177,529	$ 4,697,815	**$ 5,479,714**	$ 4,638,279

During the year, the Corporation capitalized general and administrative expenses in the amount of $179,845 (1987 - $162,123) and interest on long-term debt in the amount of $16,177 (1987 - $40,143).

5. LONG-TERM DEBT

	1988	1987
Bank production loan	**$ 800,000**	$1,700,000
Non-convertible demand debenture	**—**	400,000
	800,000	2,100,000
Less: Portion due within one year	**—**	400,000
	$ 800,000	$1,700,000

a) The bank production loan bears interest at 0.75% over the Alberta Treasury Branch's prime lending rate and is secured by a $3,000,000 fixed and floating charge debenture over the assets of the Corporation, a specific assignment of production revenue and a negative pledge covering certain oil and gas properties.

This credit facility, totalling $2,440,000, has the following repayment terms which are based on maximum utilization of the credit facility:

August 1, 1988 to December 1, 1988	– $30,000 per month
January 1, 1989 to December 1, 1989	– $40,000 per month
January 1, 1990 to December 1, 1991	– $50,000 per month
January 1, 1992 to November 1, 1992	– $51,000 per month
December 1, 1992	– payment in full

Interest on the credit facility is payable monthly.

The estimated principal payments due on the bank production loan are as follows:

1989	$ –
1990	–
1991	–
1992	545,000
1993	255,000
	$ 800,000

b) During the year, the Corporation retired the non-convertible demand debenture in full with a cash payment of $400,000.

6. CONVERTIBLE DEMAND DEBENTURE

The debenture is convertible, at any time, into 470,600 Common Shares (pre-consolidation, 4,706,000 Common Shares, note 12) of the Corporation and is secured by certain oil and gas properties. The debenture is non-interest bearing unless the debenture holder makes demand for repayment, at which time the debenture will bear interest at one per cent over a Canadian chartered bank's prime lending rate. The debenture has not been demanded for repayment.

The management of the Corporation does not anticipate that the convertible demand debenture holders will demand principal repayments within the upcoming fiscal year. As a result, the convertible demand debenture has been classified as a long-term liability.

7. SHARE CAPITAL

a) Authorized

Unlimited number of Common Shares, voting, without nominal or par value
470,600 Class A Shares, voting, without nominal or par value
1,110,113 First Preferred Shares, non-voting, without nominal or par value

b) Issued and to be issued

	Number	Stated Value
Common Shares		
Balance, July 31, 1987	8,363,503	$ 6,205,454
Issued pursuant to flow-through share agreements	4,700,000	1,175,000
Obligation to issue shares pursuant to flow-through share agreements	26,409	6,602
Balance, July 31, 1988		
— pre-consolidation	13,089,912	
— post-consolidation (note 12)	1,308,991	7,387,056
Class A Shares		
Balance, July 31, 1988 and 1987		
— pre-consolidation	4,706,000	471
— post-consolidation (note 12)	470,600	
First Preferred Shares		
Balance, July 31, 1988 and 1987	1,096,278	1,096,278
Less: Share issuance costs		(594,187)
Deficit offset against share capital (note 8)		(4,649,889)
		(5,244,076)
		$ 3,239,729

c) During the year, two agreements were entered into whereby the Corporation committed to issue 800,000 "flow-through" Common Shares (pre-consolidation, 8,000,000 Common Shares, note 12) at $2.50 per share during the period from October 21, 1987 to February 28, 1989. The proceeds received from the issuance of these shares must be spent on qualifying expenditures as defined in the Income Tax Act (Canada). Under the terms of the agreements, all government grants earned that relate to these qualifying expenditures are to be retained by the Corporation, and the Corporation must renounce $2,000,000 of tax write-offs, net of any government grants, to the subscribers during this time period.

As at July 31, 1988, the Corporation has received proceeds of $1,181,602 from subscribers for "flow-through" shares and has incurred $1,067,496 of qualifying expenditures. Net expenditures of $114,106 are to be incurred subsequent to year-end.

Subsequent to year-end, an additional $818,398 is to be received from "flow-through" share subscribers with the proceeds to be spent on qualifying expenditures. This will result in the issuance of an additional 327,359 Common Shares (pre-consolidation, 3,273,591 Common Shares, note 12).

d) The Class A Shares were issued to investors in conjunction with the $724,724 convertible demand debenture (note 6). The shares are redeemable from time to time either upon the repayment of all or a portion of the outstanding principal amount of the convertible demand debenture or upon conversion of the Class A Shares into Common Shares of the Corporation, on a basis that one Class A Share will be redeemed for each portion of the outstanding principal amount of the convertible debenture equal to $1.54 which is either repaid or converted into common shares.

e) The First Preferred Shares bear a 10% non-cumulative dividend accruing, upon declaration, from and after July 31, 1986. The shares are retractable, at the option of the holder, at a retraction value of $1.00 per share at the following rates based on the initial number of shares held by each holder:

1992 to 2001	– 5% per year
2002 to 2006	– 10% per year

The shares are fully redeemable by the Corporation at a redemption value of $1.00 per share at the option of the Corporation at any time.

8. DEFICIT OFFSET AGAINST SHARE CAPITAL

At the annual general meeting held on March 11, 1987, a special resolution was passed which authorized a reduction of the Corporation's share capital by the amount of the deficit as at July 31, 1986 pursuant to Section 36(1) of the Business Corporations Act (Alberta).

9. RELATED PARTY TRANSACTIONS

The Corporation has a participation plan whereby certain officers and employees are allowed to participate up to a total of 10% of the Corporation's working interest in new ventures. Participation is on standard industry terms.

10. INCOME TAXES

	1988	1987
Deferred income taxes	**$ 97,000**	$ 33,000
Income tax reduction resulting from utilization of loss carry-forward	**(97,000)**	(33,000)
	$ —	$ —

a) Income taxes are comprised as follows:
Accounting losses carried forward are a recurring item and therefore are not considered to be extraordinary in nature. Accounting losses carried forward result from previous years' write-downs of petroleum and natural gas leases and rights thereon.

b) Income tax expense, comprised entirely of deferred income taxes, differs from that which would be expected from applying the effective Canadian federal and provincial income tax rates to earnings before income taxes. Details of the changes are set out below:

	1988	1987
Effective Canadian income tax rate	**50.5%**	47.0%
Computed "expected" income taxes	**$ 96,234**	$ 41,595
Increase (decrease) in income taxes resulting from:		
Non-deductible crown payments, net of Alberta royalty tax credit	**17,241**	4,610
Resource allowance and earned depletion	**(9,216)**	(7,755)
Other	**(7,259)**	(5,450)
Deferred income taxes	**$ 97,000**	$ 33,000

11. COMPARATIVE FIGURES

Certain comparative figures have been reclassified to conform with current year presentation.

12. SUBSEQUENT EVENT

On December 16, 1988, the shareholders approved the change of the Corporation's name to Cube Energy Corp. in conjunction with the consolidation of the Corporation's Common Shares and Class A Shares on the basis of 1 new share for each 10 previously outstanding shares.

Earnings per share, fully diluted earnings per share and cash flow per share have been restated to reflect the share consolidation.

Notes 6 and 7 to the consolidated financial statements have been restated to reflect the consolidation of the Common Shares and Class A Shares.

AUDITORS' REPORT

To the Shareholders
Cube Energy Corp.
(formerly First Devonian Explorations Ltd.)

We have examined the consolidated balance sheet of Cube Energy Corp. (formerly First Devonian Explorations Ltd.) as at July 31, 1988 and the consolidated statements of earnings, retained earnings and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these consolidated financial statements present fairly the financial position of the Corporation as at July 31, 1988 and the results of its operations and changes in its financial position for the year then ended in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Calgary, Alberta
November 17, 1988, except as to Note 12
which is as of January 10, 1989

COLLINS BARROW
CHARTERED ACCOUNTANTS

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